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SUBJECT: EGYPT: QUARTERLY ECONOMIC REPORT

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SUMMARY  
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1. In this edition: The Central Bank intervenes to raise interest rates, parliament decreases stamp taxes and considers a single Treasury account, while the GOE increases cooperation with China. Industry organizations sign a cooperative agreement with major banks to finance new factories. Egypt's exports surge, Turkey invests in the textile sector and China is denied market status. A Gulf investor bids to purchase 25 percent of EFG-Hermes, Egypt's largest investment bank. The Ministry of Communication and Information Technology signs several agreements with the World Bank and Mubarak establishes a new university dedicated to info technology. Kuwaiti and Spanish firms invest in Egypt's oil and gas sectors, and the Ministry of Electricity plans to build several plants to increase electrical output. Suez Canal revenues soar. End summary.

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MACROECONOMIC  
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2. INTEREST RATES: In mid-July, the IMF warned the Central Bank (CBE) against further reduction in interest rates until liquidity growth had decelerated and inflation stabilized. Inflation increased from 4.4 percent in April to 6.4 percent in June. The IMF recommended strict limits on government financing. In an apparent response, CBE announced a new saving instrument on July 31, with interest rates between 7-7.5 percent and maturities of 4, 6 months and 12 months. CBE Deputy Governor Tarek Amer told the press that CBE's market intervention was due to distortions in interest rates; bank rates on deposits were as low as 4-5 percent while earning risk-free gains of 8.9-9.2 percent on government securities. The new instrument was expected to increase short term interest rates on deposits. The CBP plans to end its intervention once stable short term interest rates are restored.

3. STAMP TAX LAW: In late June, parliament amended the Stamp Duty Law of 1980 by simplifying procedures and reducing tax rates on some products and services. Rates on radio, TV, cinema and print ads were reduced to 15 percent, while a new rate of 15 percent was imposed on billboard ads. Rates on life insurance premiums were reduced from 3 to 1 percent, while rates on maritime, land and air transportation insurance premiums were reduced from 15 to 10 percent. Rates on credit accounts and loans were also reduced from LE .01 to LE .001 piaster. The Tax Authority will automatically dismiss tax disputes under LE 5,000 (\$877) to reduce collection costs.

4. SINGLE TREASURY ACCOUNT: Parliament is considering

establishment of a unified Treasury account to consolidate LE 83 billion (\$1.4b) in 48,000 accounts held by governmental authorities and agencies into fewer than 20. The new law would promote more efficient fiscal management and increase control of off-budget resources. The IMF has been urging this reform for years.

¶15. CURRENCY: Metallic LE .01 and .50 piaster coins have been issued, after a decision to eliminate their paper equivalents. Paper LE .01 and .50 piaster bills will be gradually removed from the market.

¶16. ECONOMIC DEVELOPMENT PLAN: The Ministry of Finance will establish a Central Unit for Public-Private Partnerships (PPP). In the short term, the unit will focus on promoting public-private sector partnerships for school and hospital construction, but may eventually include utilities and other service areas. The legal framework is still under preparation.

¶17. COOPERATION WITH CHINA: Chinese Prime Minister Wen Jiabao visited Egypt in June. Jiabao met with President Mubarak to discuss economic and trade relations and with PM Nazif, with whom he signed 10 agreements on oil and natural gas, telecommunications, and resumption of Egyptian citrus exports to China. China will provide a \$50 million loan and a \$10 million grant to build an investment headquarters in the industrial area northwest of the Gulf of Suez. Telecom Egypt and the Chinese company Huawei Technologies have agreed to manufacture CDMA wireless local loop terminals in Egypt.

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INDUSTRY  
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¶18. The Federation of Egyptian Industries, the Industrial Modernization Center and the Egyptian Banking Federation will provide LE 75 billion (\$13b) over the next five years to finance new factories and expand existing ones, part of Mubarak's campaign promise to build 1000 new factories. PM Nazif has said the GOE will provide 10 million square meters of land annually, complete with infrastructure, for construction of industrial export projects. The GOE also plans to will upgrade existing industrial zones and construct 1700 small factories over the next 18 months, and to provide LE 1.5 billion (\$263m) to upgrade utilities in new urban communities.

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TRADE  
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¶19. DDA TALKS: Minister of Trade and Industry Rachid has announced that, in view of the suspension of the WTO Doha Development Agenda, Egypt will focus on its Arab and European trade partners within the framework of the Arab Free Trade Area and the Euro-Mediterranean Partnership. He added that Egypt is ready to cooperate to revive the round.

¶110. EXPORTS SURGE: Egyptian exports reached \$8.1 billion over the 11 months ending in May, seven percent over projections. Trade Minister Rachid credited the newly-restructured Egyptian Exports Promotion Center, which builds the capacity of exports councils, directs exporters to development funds, provides training and technical assistance and monitors service provision. Rachid noted challenges still facing Egypt's exports, including transportation, shipping, marketing and an absence of Egyptian trademarks.

¶111. EGYPT DENIES CHINA MARKET ECONOMY STATUS: Rachid, supported by the Federation of Egyptian Industries (FEI), announced Egypt's opposition to China's recognition as a market economy at the WTO. The FEI has criticized the impact of China's undervalued currency, export subsidies and dumping strategies on Egyptian industry.

¶112. TURKISH TEXTILE INVESTMENTS IN EGYPT: Egypt's FTA with Turkey is attracting Turkish FDI to the textiles sector. Eyeing the benefits of the QIZs, along with Egypt's preferential agreements with EU, COMESA and GAFTA, 17 Turkish companies, with investments of \$63 million, are operating in Egypt. Investment is expected to rise to \$1.5 billion by the time the agreement enters into force in late 2006. Trade Minister Rachid attributed the increase of Turkish investments to Egypt's low costs, QIZ privileges, and investment

incentives.

¶13. INTRA-ARAB TRADE: The Council of Arab Economic Unity approved Egypt's proposal to increase intra-Arab in-kind trade. To promote intra-Arab trade, member states agreed to establish a holding company for agricultural equipment production, an investment services corporation, as well as a new Arab investor identification card to ease investor travel and simplified port procedures.

¶14. FOREIGN TRADE STATISTICS: Egypt's trade deficit increased 69 percent in 2005 to \$9.1 billion, with exports rising 39 percent to \$10.6 billion, and imports by 54 percent to \$19.8 billion. Petroleum exports rose 69 percent to \$5.2 billion, compared to a 17.6 percent rise in non-oil exports to \$5.4 billion. Increasing petroleum import costs, up 78 percent to \$1.8 billion, were a major factor. Non-oil imports increased by 52.4 percent to \$18 billion, with raw materials making up the majority of the increase in non-oil imports, rising 87.8 percent, followed by intermediate goods rising 46 percent; investment goods, 36 percent; and consumption goods, 35.7 percent.

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CAPITAL MARKETS  
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¶15. EFG-Hermes has accepted a bid by Dubai-based Abraaj Capital to acquire 25 percent, or 97,074,010 common shares, of EFG-Hermes' stock at share price of LE 30. The acquisition will be made through a wholly-owned subsidiary, Abraaj Egypt Limited; the transaction is worth \$505 million. The transaction must be approved by shareholders and regulatory authorities. If approved, Abraaj Capital will be the largest single shareholder in EFG-Hermes, which in turn is the largest shareholder in Lebanon's Bank Audi.

¶16. Shares in EFG-Hermes, regarded as the region's leading investment bank, jumped 23.8 percent on news of the offer. Listed on both the Cairo and London stock exchanges, it is two-thirds publicly owned and has more than 40 percent of the market for securities brokering in Egypt. EFG has won about 7 percent of the securities brokering market in the United Arab Emirates since opening an office there in 2004. This year the firm received a license to operate investment banking and asset management activities at the Dubai International Financial Exchange and a license to operate in Saudi Arabia.

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COMMUNICATIONS AND INFORMATION TECHNOLOGY  
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¶17. Minister of Communication and Information Technology (MCIT) Tarek Kamel and his Syrian counterpart, Amr Nazir Salem, recently signed an MOU for bilateral cooperation in communications and information technology. MCIT will help Syria develop communications regulations, including for IPR, e-commerce, online payment, electronic crime, and e-signatures. In addition, both parties will cooperate in developing human capacities by exchanging training experiences and organizing bilateral and regional workshops.

¶18. During a visit to the U.S. this summer, MCIT Minister Kamel witnessed the signature of several agreements between the World Bank and GOE agencies. The National Postal Authority (NPA) signed an agreement to restructure, and to develop postal services, with a focus on human resources. The Information Technology Industrial Development Authority signed an agreement to increase use of e-signatures, protect IPR, and increase information technology exports. Kamel signed an agreement to develop and liberalize communications services. During the visit, Lucent and Telecom Egypt agreed to establish 50,000 phone lines using CDMA technology. During the visit, Kamel said subscribers to both mobile and fixed telephone lines in Egypt will reach 26 million by the end of 2006 - which would mean 36.2 percent overall telephone density in Egypt - while Internet users were projected to reach 5.5 million. He stressed that even Egypt's smallest population centers are now covered by stationary lines via 1,131 telephone exchanges.

¶19. Also in June, the National Telecommunication Regulatory Agency (NTRA), in conjunction with Egyptian internet service providers and Telecom Egypt, agreed to reduce the price of Asymmetric Digital Subscriber Line (ADSL) by 40 percent. The decision came as part of the NTRA's efforts to increase accessibility to ADSL services and

broaden the base of internet users in Egyptian governorates, especially as the latest statistics reveal that 90 percent of internet users are clustered in Cairo and Alexandria. Currently, ADSL users are only about 130,000, but are expected to reach half a million by the end of 2007.

¶20. In July, Mobinil and Vodafone share prices increased dramatically in reaction to the Emirati-led consortium Etilat's payment of LE 16.7 billion (\$2.91 billion) for Egypt's third mobile license. Mobilnil topped the best performer's list, soaring by 20.0 percent to finish at LE 156.02. Vodafone rose by 9.6 percent, to close at LE 91.16. On the other hand, Telecom Egypt witnessed heavy selling, trading at EGP 11.67, a 2.8 percent decline. Also in July, IRAQNA's (affiliated with Orascom Telecom) license for mobile service was extended until the end of September. Reports indicated IRAQNA mobile subscribers reached 2.2 million as of March 2006. Investments in the IRAQNA GSM network are reportedly over \$ 250 million.

¶21. On July 16, President Mubarak issued a Presidential Decree to establish Nile University in 6th of October City on the outskirts of Cairo. The university's mission is to expand Egypt's scientific and technological base in the field of information technology and communications. The new university will partner with Egyptian industries and business associations as well as international universities and research institutes in order to achieve its goals. The university is expected to begin offering classes in September 2007 with graduate programs in business and engineering and offering masters degrees in technology managements.

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ENERGY  
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¶22. OIL AND GAS: Wood Mackenzie Consulting recently presented a study at the Egyptian Petroleum Society indicating that sharp increases in oil prices, drilling equipment fees and the cost of deep marine drilling operations, are the main obstacle to gas investments and further development of a domestic gas market. However, the study also indicated the success rate in finding gas in Egypt is three times higher than for the rest of the world. Proven gas reserves in Egypt are about 67 trillion cubic feet (TCF); probable reserves in the deep Mediterranean region are estimated at 70 TCF. Egyptian Minister of Petroleum Fahmy challenged the study's figures for probable gas reserves, claiming reserves are approximately 90 TCF. Most industry experts believe the GOE's figures are overly optimistic.

¶23. On June 7, the Kuwait Energy Company (KEC) announced the purchase of 37.5 percent of the Gharib field in the northwestern desert of Egypt. KEC officials say this is the first in a series of potential projects in Egypt. KEC was established in August 2005 with the aim of becoming a key independent oil and gas company, and hopes for production of 50,000 barrels/day with net reserves of 300 million barrels by 2010.

¶24. The Spanish electrical company Union Fenosa has signed a framework agreement with the Italian company Eni, the Egyptian Natural Gas Holding Company (EGAS), and the Egyptian General Petroleum Corporation to double the output of the LNG facility in Damietta. Under the agreement, the consortium will build a second LNG train, to be operational by 2011, with a capacity of 7 billion cubic meters (BCM) a year. Total output from Damietta will reach 14 BCM per year, or slightly less than half of Spain's total demand.

¶25. In late July, press reports indicated that the Eastern Mediterranean Gas Company (EMG), an Israeli-Egyptian joint venture company, had resumed talks with Israeli customers willing to purchase gas at 2006 market prices. While EMG did not say with whom it was negotiating, the report indicated that the potential customers were cement, power and chemical enterprises. EMG currently has one contract in Israel, for sale of 1.7 BCM annually to Israel Electric Corporation.

¶26. ELECTRICITY: This summer, Minister of Electricity Hassan Younis announced Arab and international investors will finance most projects in the GOE five year plan. The plan includes construction

of 14 new plants with total capacity of 7,957 megawatts. Younis denied rumors that the GOE will either privatize or conduct IPOs of shares of electrical companies. He said recent fuel and natural gas price increases will not affect electricity but noted that prices in Egypt are low compared to region, and that subsidies cost the GOE LE 3 billion (\$526m) per year.

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SUEZ CANAL  
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¶27. Canal revenues, Egypt's third largest source of income, were \$1.2 billion in January-June 2006, compared to \$3.4 billion for all of 2005. The Suez Canal Authority expects annual revenues to increase 12-13 percent over 2005. Increases are a result of a 3 percent hike in transit fees, as well as an increase in traffic (1575 ships in the same six month period). On July 26, Egypt celebrated the 50th anniversary of Nasser's nationalization of the Suez Canal.

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ECONOMIC INDICATORS  
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¶28.

Exchange Rate:

	(06/29/06)	(08/31/06)	
Egyptian Pounds/\$	Buying	Selling	Buying
Avg. Bank/Bureau Rate	575.24	577.18	573.76 575.84

Capital Market:

	(06/29/06)	(08/31/06)	
CASE 30 Index		5,298	5,674
Hermes Financial Index		47,364	50,025
EFG Index	24,055	25,509	

Interest Rates:

(percent, monthly comparison)

Interbank Overnight	8.3 (06/28)	8.1
T-bills (182 days)	8.97(06/27)	8.99(08/01)
T-Bond (maturing 12/08)	9.1 (06/15)	9.25(07/25)
T-Bond (maturing 10/11)	9.0 (06/25)	9.1

Foreign Reserves:

(US \$ billion, official gov't figures)

	(06/2006)	(08/2006)	
	22,930.0	23,051.1	
Interbank Overnight	8.185(05/30)	8.3 (06/28)	
T-bills (182 days)	8.727	N/A	
T-Bond (maturing 12/08)	8.94(05/25)	9.1 (06/15)	
T-Bond (maturing 10/11)	8.9 (05/15)	9.0 (06/25)	

Foreign Reserves:

(US \$ billion, official gov't figures)

(05/2006)	(08/2006)
22,860.0	22,930.